

Oklahoma Economic Report

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

Deciphering the debt

The looming August 2 debt ceiling deadline has prompted a national discussion on the cause of the crisis and the necessary corrective steps. While virtually all agree the United States has a debt problem, there is no singularity of thought on the origin or fix.

There are only two possible causes: too little tax revenue or too much spending. In the nation's capitol, the solution depends on where one is on the political spectrum.

Outside Washington, there is much more uniformity on the root and remedy.

Recent polls depict a public almost split over whether to raise the cap, but decidedly more resolute on the cause. While the statutory limit on federal debt has been raised 74 times in the last 50 years, the current public perception is that spending is out of control and raising the cap again might be a no-win scenario.

On one hand, to raise the debt ceiling is to condone the federal government's overspending. On the other hand, failure to raise the limit is to damage America's global leadership and its fragile economy. With government spending

on a seemingly unsustainable path, the debt ceiling debate has become the line in the sand for a public wary and weary of Washington's ways. And with federal spending having grown seven times faster than median household income the last forty years, the consternation is understood.

The average household understands the need to use debt in a budget. However, those same households recognize the difference between using a mortgage to finance a house and borrowing money to pay monthly expenses like groceries and utilities.

In Oklahoma, as with most states, government spending for operating

SEE DEBT PAGE 3

Inside

- Treasurer's Commentary: It's the spending, stupid!
- Recovery speeding up
- Gross receipts and General Revenue for fiscal year compared
- Saving for the next rain <u>Contributors</u>

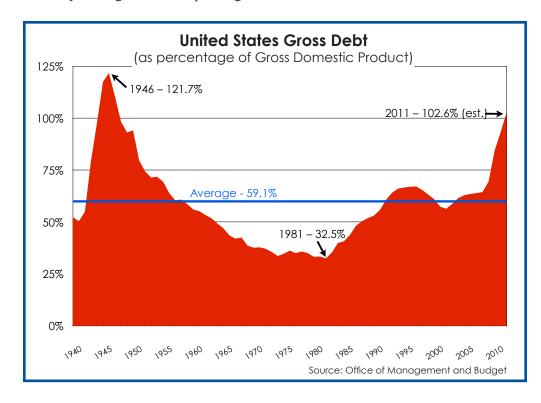
Regina Birchum, Deputy Treasurer for Policy

Travis Monroe, Director of Budget & Finance

Paul Ackerman, CPA

Editor

Tim Allen, Deputy Treasurer for Communications



Treasurer's Commentary By Ken Miller, Ph.D.

It's the spending, stupid!

While recent reports show state economic prospects heating up, no recovery is guaranteed. Oklahoma is not immune from macroeconomic conditions or bad decisions made in our nation's capitol. Unfortunately, the current Washington stalemate threatens our economic recovery just as it's catching fire.

With the federal government borrowing 40-cents of every dollar spent, much focus is on the US debt crisis. In the last 10 years alone, the gross federal debt has ballooned about 150 percent from \$5.8 trillion to \$14.3 trillion. This is an increase from 56 percent of GDP in 2001 to more than 100 percent today. The cause is simple - it's the spending, stupid!

Nearly 200 years ago, political observer Alex de Tocqueville wrote, "The American Republic will endure until the day Congress discovers that it can bribe the public with the public's money." Studies show most voters negatively view spending in the aggregate, but positively view spending on favored programs that comprise about 90 percent of the federal budget.

Some of our recent deficits are attributable to prolonged war and

deep recession. But much of the debt is the consequence of politicians who can't refuse special interests that demand more government than we can afford, and it's a bipartisan affair.

The debt ceiling was raised seven times under the most recent Republican president and debt grew under the last four. The current Democratic president accelerated the debt by more than \$1 trillion each year. Congress under both parties has spent freely.

•• ... the current Washington stalemate threatens our economic recovery just as it's catching fire."

The consequences of continued irresponsibility would be devastating. The global economy is built on the full faith and credit of the United States. If that faith were damaged by default or austerity, Oklahoma would suffer from



negative effects on the dollar, interest rates, investment, consumption and jobs. Billions of federal tax dollars returned to Oklahoma for core functions would be in doubt and \$4 billion of state investment in federal securities could be at risk.

The President and Congress have left the country the choice between bad and worse: going further in debt or default. Now, they must finally take action with a credible long-term deficit reduction plan that takes into account fragile aggregate demand and the peril of defaulting on U.S. debt.

Once our national leaders avert the immediate crisis, they must commit to strict constitutional spending constraints that include a cap and balanced budget requirement. If policymakers would just return to our post-depression debt average near 60 percent of GDP, our \$14 trillion economy would have to grow \$10 trillion to reach the debt ceiling.

SEE COMMENTARY PAGE 3

Commentary

FROM PAGE 2

Though Tocqueville warned representative democracy lends itself to overspending, he also said, "the greatness of America lies not in being more enlightened than any other nation, but rather in her ability to repair her own faults."

America is best equipped to tackle her faults when we work together to correct them. Our country is facing a defining moment that requires statesmen to work in a bipartisan manner so American exceptionalism survives to benefit the next generation.

Debt

FROM PAGE 1

purposes is limited to the amount of available revenue. The state uses debt to finance long-term infrastructure projects. Oklahoma has been especially responsible on this front, ranking among the states with the lowest tax-supported debt.

By contrast, the federal government is borrowing approximately \$125 billion each month just to pay its bills. Each year's deficit continues to add to the nation's debt, exponentially growing the principle and interest required to repay households, businesses and governments, both foreign and domestic.

The category of government debt most commonly cited is publicly held debt, which consists primarily of treasury securities held by outside investors. The United States' gross debt, the sum of publicly held debt and debt held by government, is the world's largest

in total dollars. However, the amount of gross debt relative to the size of

government is borrowing approximately \$125 billion each month just to pay its bills."

the economy, or debt as a percentage of gross domestic product (GDP), is considered a better indicator of economic health. Using the debt-to-GDP ratio, U.S. debt ranks third among the 10 largest economies - and it is at its highest level since WWII.

The global impact of a country's indebtedness is relative to its size and economic might. Credit downgrades levied against much smaller economics like Portugal, Greece and most recently, Ireland, have resulted in a weaker euro and a market pullback. Greece alone, with an economy representing less than two percent of the euro zone, has caused considerable problems for the region.

Fiscal problems in larger countries have a much greater effect on world markets. Long the world's largest economy, the United States has endured deep recession and slower growth as its debt has mounted. Japan, with the highest debt ratio of industrialized economies at more than twice its GDP, has struggled economically for a decade and recently relinquished its position as the second largest economy to China.

It is often said that when the United States sneezes, the rest of the world catches a cold. If true, then certainly the combined debt problems of the United States, Japan and the European Union – which together supply 45 percent of world output and more than 90 percent of international reserve currencies – have slowed the global recovery and could become a massive destabilizing force throughout the globe, if debt levels are not curtailed and the U.S. debt limit not addressed.

Of course, raising the debt ceiling doesn't actually authorize more spending – that can only be done through the appropriations process. Lifting the cap would enable the government to follow through on previously passed budgets by continuing

SEE DEBT PAGE 5

Little known fact

If the federal government fails to raise the debt ceiling and defaults on some of its debt, it would not be the first time but it would be unprecedented in its scope and impact. Under reported is the fact that a technical default occurred in 1979, when \$120 million in Treasury bills were not timely paid.

Although the payments were eventually made, and despite the fact that the \$120 million represented just .015 percent of the total \$800 billion in Treasury debt at the time, the default resulted in higher interest rates being applied to all government securities – an expense of about \$6 billion a year.

Fiscal Year General Revenue Fund Allocation

A comparison of the Treasurer's July 5 Revenue Report and State Finance's July 11 General Revenue (GR) Fund report demonstrates the differences for a full fiscal year.

12-month gross receipts totaled \$10.205 billion, while GR received \$5.108 billion or 50.1 percent during FY 2011.

The difference is due to variances in the transfer of funds for rebates, remittances and dedicated funding.

In FY-11, the GR Fund received:

- 60.1 percent of personal income tax
- 61.1 percent of corporate income tax
- 44.9 percent of sales tax receipts
- 49.9 percent of gross production taxes on oil and natural gas
- 31.1 percent of motor vehicle tax collections
- 46.9 percent of other revenue sources

Collections from tribal gaming generated \$122.2 million during FY-11

Insurance premium taxes generated \$172.1 million during the fiscal year.

June revenue shows state economic growth accelerating

Oklahoma's economy is expanding at an accelerating pace, Treasurer Ken Miller announced as he released the revenue report on total tax commission collections in June.

"Now entering the third year of the cyclical expansion, Oklahoma's double-digit revenue growth last month shows our state's economy is clearly regaining its strength while the national economy continues its rather anemic growth."

Miller said.

"Gross receipts, reflecting a crosssection of the state's economic activity, are encouraging from top to bottom," he said. "Again this month, every major category shows growth with earnings and consumption especially strong."

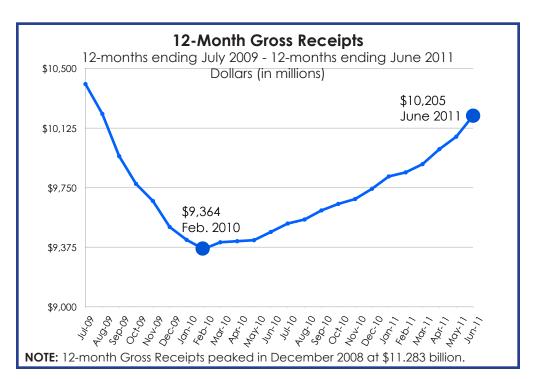
June collections compared to a year ago surged by more than 15 percent, the

report from the state treasurer's office shows.

economy is clearly regaining its strength while the national economy continues its rather anemic growth."

Collections for the past 12 months are almost eight percent above the trailing

SEE REVENUE PAGE 5



Debt

FROM PAGE 3

to meet obligations on debt already incurred and by fulfilling other commitments already promised.

Contrary to government actions, U.S. households have changed their personal spending habits by saving more and borrowing less. America's personal savings rate nearly doubled from April 2008 to April 2011. The Fed's flow of funds report shows household's total net worth is climbing as their borrowing and debt go down for the 12th consecutive quarter.

Debt by the numbers

At the end of 2010, gross federal debt totaled \$13.5 trillion: the 9.0 trillion in debt held by the public plus 4.5 trillion in debt held by government accounts, of which more than half is in the Social Security trust funds.

The current annual interest cost on

the federal debt is approximately \$200 billion, calculated at historically low interest rates. Net interest payments over the next 10 years are projected to increase fourfold with the expected rise in interest rates, to approximately \$778 billion in 2020.

Source: Congressional Budget Office

Leadership by example is a stalwart management practice often used to show subordinates what is expected. The American people are making the difficult adjustments necessary to emerge from recession and personal financial crises. Time will reveal if their representatives will now follow suit.

Revenue

FROM PAGE 4

12 months, according to the report. "Month after month, the Oklahoma economy gains steam," Miller said.

External Threats

"Right now the major concerns that threaten this momentum are external and stem from Washington's failure to address the U.S. debt crisis, and to a lesser extent, the EU's problems with Greece and the continued unrest in the Middle East. We will also keep an eye on gasoline as the current easing on pump prices is likely

temporary. Otherwise, our economic prospects are largely promising," he continued. "Congress should have never put the United States in the dangerous situation of having to choose between irresponsibly raising the debt ceiling again or the catastrophic default on debt," Miller said.

"Hopefully, our national leaders will finally take responsible action on the debt crisis with a credible long-term deficit reduction plan that takes into account the fragile aggregate demand and the absolute peril of defaulting on U.S. debt."

Positive Signs, Otherwise

Miller pointed to two recent reports that

underscore the positive revenue trend on the outlook for the state economy.

The state's unemployment rate dropped again in May to 5.3 percent. One year ago, state unemployment stood at 7.1 percent. National unemployment in May was 9.1 percent. "At nearly four percentage points below the national unemployment rate, Oklahoma's job market is not where it needs to be, but is exceptional on a relative basis."

Miller said a recent report commissioned by the U.S. Conference of Mayors and prepared by economic forecasters IHS Global Insight also paints a bright outlook for Oklahoma.

"The report predicts some U.S. metropolitan areas will not reach prerecession levels until 2020, but says Oklahoma's three metro areas will fare much better," he said.

According to the report, the Lawton area should fully recover within the next year; Oklahoma City during 2013 and Tulsa in 2014.

Market Anticipates U.S. Debt Agreement

Global markets appear confident that the U.S. will reach an agreement to raise the debt ceiling, but there is apparently not as much confidence in the debt crisis in Europe.

That difference of opinion is reflected in the Treasury market where the safety bid is again holding yields near the lower end of the 2011 ranges.

Replenishing the Constitutional Reserve Fund

Saving for the next rain

The balance in the Constitutional Reserve Fund, also known as the Rainy Day Fund, has gone from \$2.03 to more than \$219.4 million, according to the Office of State Finance.

The deposit comes as General Revenue Fund collections for Fiscal Year 2011 exceeded the official estimate by 15.7 percent, Preston Doerflinger, state finance director, announced this week.

The deposit is the largest to the Rainy Day Fund since July 2005, the beginning of Fiscal Year 2006, when \$243.8 million was placed into the fund. It is the first deposit to the fund since the beginning of Fiscal Year 2009.

The \$596.57 million the fund contained

at the beginning of Fiscal Year 2009 was used during the next following three years to shore up deep reductions in revenue collections due to the Great Recession.

The deposit is the largest to the Rainy Day Fund since July 2005."

The final \$100 million from the fund was transferred at the end of the

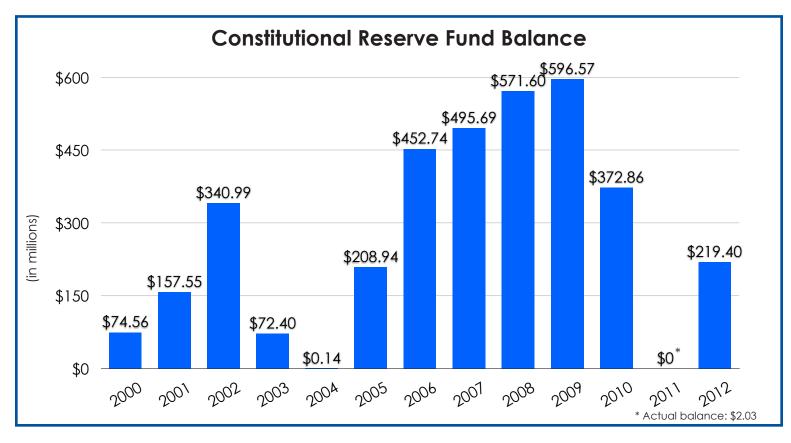
2010 Legislative session for use in appropriations for Fiscal Year 2012.

In November 2010, state voters approved raising the cap on the fund from 10 percent to 15 percent of the previous fiscal year's collections.

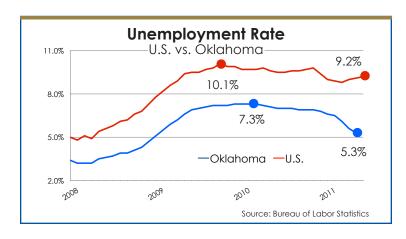
Proponents of the state question argued the higher cap was needed to provide sufficient funds in the event of a recession similar to the most recent one.

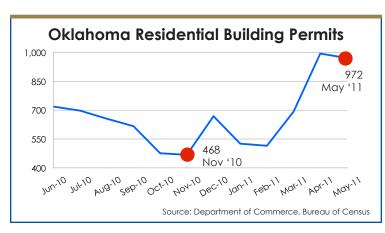
Up to three-eights of the fund can be appropriated when collections from the current fiscal year drop below appropriated levels. Another three-eights can be used when the official estimate for the next fiscal year are less than the current one.

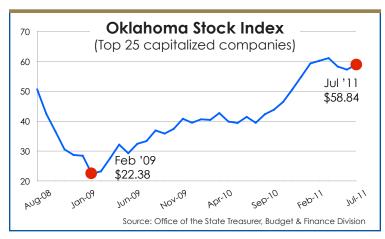
A maximum of 25 percent of the fund can be used for emergencies, as declared by the governor and approved by the Legislature.

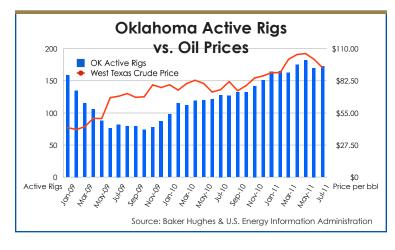


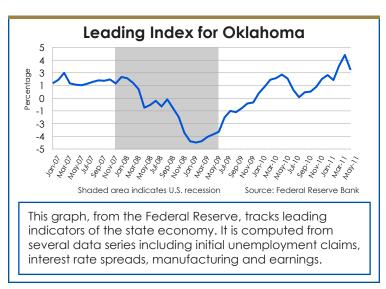
Economic Indicators











Interest Rate Forecast						
68 Economists Fed Funds Target	2Q 2011 0.25%	3Q 2011 0.25%	4Q 2011 0.25%	1Q 2012 0.25%	2Q 2012 0.50%	3Q 2012 0.80%
3-M LIBOR	0.26%	0.31%	0.40%	0.50%	0.71%	1.10%
<u>Treasury Notes</u>						
2-Year	0.50%	0.75%	1.00%	1.25%	1.51%	1.80%
10-Year	3.18%	3.40%	3.66%	3.80%	4.00%	4.12%
<u>Treasury Bonds</u>						
30-Year	4.30%	4.50%	4.73%	4.90%	5.00%	5.13%
Economic Indicators	2011		2012			
Real GDP	2.5%		3.04%			
Unemployment	8.8%		8.2%			
Source: Median forecasts for key economic indicators as surveyed by Bloomberg July 5-9.						